Report of the

Canola Marketing Task Force

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Canada

Executive Summary

Background

1. – Canola is a cash crop of major importance (over $1 billion annually) to the Western Canadian economy.

   – Canadian canola production comprises 15-20 percent of world canola/rapeseed production, while Canadian canola oil exports make up less than ten percent of world canola oil exports, and less than one percent of world vegetable oil exports.

   – Canadian influence in world oilseed and particularly product markets is relatively small. However, the international trade environment has a significant impact on the domestic canola industry.

2. – Although dominant in the Canadian vegetable oil market (60 percent share), canola oil has only a 2-3 percent share of the large U.S. vegetable oil market.

   – GRAS status (1985), declining tariffs under the Canada-U.S. Trade Agreement (CUSTA), increasing health consciousness among consumers, and the low saturated fat content of canola oil have all contributed to the increasing U.S. market opportunity.

   – Despite the size and proximity of the U.S. market, there are problems to be overcome if the Canadian canola industry, and particularly Western crushers, are to successfully meet the challenge.

3. – The relative emphasis in this report is a reflection of existing problems and issues, and is not intended to favour the interests of any individual sector.

   – Profitability and mutual confidence among all industry sectors - including canola growers, exporters, and domestic processors - are necessary to ensure long term success in the industry.

   – Recommendations have attempted to take into account the interdependence of all industry sectors, as well as the context of the Canadian canola industry in today's global marketplace.

Major Issues

Major issues confronting the canola industry can be divided into four categories:

- International trade distortions affecting all sectors caused by subsidies and tariffs. These include:
  - Japanese customs tariff on vegetable oil
  - EEC oilseed crushing subsidies
  - U.S. vegetable oil export subsidies
- Problems within the Canadian crushing sector relating to ownership, capacity, and destructive competition in product markets.
- Domestic government policies that discriminate against value added processing.
- The canola marketing system.

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Recommendations

1. The Canola Marketing Task Force recommends that industry participants and Governments develop a commitment to domestic value added processing. One of the primary issues in need of resolution is the method of payment of the Western Grain Transportation Act (WGTA) subsidy. The Task Force seeks a resolution of the present disadvantage for Canadian canola processors of the current WGTA legislation, within the context of total industry requirements, specifically resulting in improved benefits and cost savings for farmers and processors.

2. The Task Force recommends that the Alberta Government divest itself of ownership of Alberta Terminals Canola Crushers Ltd. and work with industry participants and other Governments to help reorganize ownership in the Canadian canola crushing sector.

3. The Task Force recommends that governments allow rationalization of ownership in the canola processing industry to an optimal structure.

4. The Task Force recommends that the Federal Government continue maximum effort to establish an international trade environment free of distortions. In the immediate future, this effort should focus on the problem of subsidized European low erucic acid rapeseed (LEAR) oil entering the U.S. in direct and unfair competition with Canadian canola oil, and accelerated tariff reduction for canola and canola products under the CUSTA.

5. The Task Force, with the exception of Prairie Pools Inc. and J. Leibfried, recommend:

   - that delivery quotas and permit book entries for canola, and the requirement to report canola inventory positions to the Canadian Wheat Board be eliminated;
   - that bonding rates reflect financial viability and risk in all sectors of the industry; and
   - overall regulatory review and modification of regulations to increase cost efficiency and the ability of market forces to effect the flow of commodities into and through the commercial handling system.

   Prairie Pools Inc. and J. Leibfried believe that regulatory change should be done only as part of a total industry consultation process including all other grains and oilseeds.

6. The Task Force recommends:

   - that the Canola Council of Canada's modified *Blueprint for the '90's* be adopted by industry and government;
   - that the funding necessary to implement associated research, technology transfer, and market development programs be granted by Western Economic Diversification Canada; and
   - that in the longer term, grower, industry and government funding for canola research and development programs be increased so as to maintain and improve the advantage that Canada has developed in production and quality.

7. The Task Force recommends that if the GATT negotiations fail, the CIDA bilateral food aid program be redesigned to accommodate both commercial and humanitarian interests. In cases where commercial imports and Canadian aid donations are combined to meet domestic requirements, the memorandum of understanding which establishes the bilateral food aid program should include a commitment by the recipient to make minimum annual commercial purchases of Canadian canola oil.

8. The Task Force recommends that if the GATT negotiations fail, the Canadian Government respond to the Canadian oilseed industry in its bid to become competitive in export markets by extending the same form of credit sales facilities as those used by their major competitors. This could include such measures as extended terms of repayment, concessional rates of interest, and subsidized product prices.

9. The Task Force supports the Winnipeg Commodity Exchange initiative to establish canola options with funding from Western Economic Diversification Canada, in conjunction with a significant effort to promote options in the farm community and educate potential users. As well, a significant effort should be made to educate farmers about other aspects of marketing, such as price relationships, futures markets, and various marketing options.

10. The Task Force, with the exception of Prairie Pools Inc. and J. Leibfried, recommend that the current open market system for canola be

retained. Prairie Pools Inc. and J. Leibfried advocate the placement of canola under the jurisdiction of the Canadian Wheat Board.

11. The Task Force recommends that the federal government negotiate the removal of the Japanese vegetable oil import tariff, but only in conjunction with an overall reduction in production and export subsidies in competing oilseed producing regions. The Task Force recognizes that the Japanese oil tariff is a major detrimental factor negatively affecting the competitive position of domestic processors.

12. The Task Force recommends that farm income stabilization programs be designed to be crop neutral with regard to both production and trade.

Other Issues

1. The current WCE canola futures contract is deemed fully adequate by Japanese importers and Canadian exporters, but is viewed as unsatisfactory by domestic crushers. This dissatisfaction with the futures price relative to product prices, although directed to the Exchange in recent years, is a consequence of the inherent squeeze between Japanese buying power for canola and an abundant supply of oilseed products in North America. In terms of nominal futures prices, the current contract reflects the reality of the current market, which is dominated by Japanese importers with buying power far in excess of Canadian crushers'. In terms of its two primary functions, price discovery and risk management, the contract is functioning properly.

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Introduction

A. Role of the Task Force

In response to various concerns in the Canadian canola industry, the Federal Agriculture Minister responsible for grains and oilseeds met with representatives from all sectors of the industry on February 19, 1990.

Amidst the discussion, a consensus emerged that an industry task force be established to study issues of concern and make recommendations to Government.

The Canola Marketing Task Force was formed in March, 1990 to assess the full range of factors affecting the continued growth of the Canadian canola industry. These factors include:

1. Policies impacting on the competitiveness of canola production, marketing and processing;
2. Future market potential for canola and canola products;
3. Technological factors impacting on the competitiveness of canola production, marketing and processing;
4. The effectiveness of the existing price discovery mechanism in (a) transmitting market returns back to producers, and (b) enabling the domestic crushing sector to secure seed requirements; and
5. Alternative price discovery mechanisms and selling arrangements which might be employed.

The task force examined not only the status of these factors, but also changes that could be made both in the short and longer term to positively affect the industry.

B. Task Force Methodology

The Task Force met for roughly two days each month from April to November, 1990. It consisted of twelve members representing all sectors of the Canadian canola industry (see Appendix 1), as well as support members from the following organizations: Canadian Grain Commission, Canadian Wheat Board, Grain Marketing Bureau, Grain Transportation Agency, and National Grains Bureau.

At the outset of the process, each member was given an opportunity to raise issues deemed relevant to the canola industry, which were subsequently ranked in terms of priority.

All Task Force deliberations were conducted with the entire group, as no sub-committees were formed. In addition to reviewing issues relevant to the canola industry, the Task Force set out to provide an industry driven, industry agreed upon set of recommendations upon which to build. It was agreed that discussions should focus on the total industry in today's global marketplace, and that recommendations should take into account all sectors of the industry.

The Canadian Canola Industry

A. Background

1. Economic Importance

Canola is Canada's major oilseed crop, accounting for 65-70 percent of Canadian oilseed production. It is second only to wheat in terms of gross farm income, averaging $850-900 million per year. Japan is the predominant export market for canola seed (over $600 million annually), taking up to 90 percent of total exports and up to 60 percent of canola production. The balance of the crop is sold to the domestic crushing sector, most of which is located in Western Canada.

Canola contributes more per acre to the farm economy than cereal grains such as wheat or barley. Average revenue per acre from canola in Western Canada during the 1980's was $137, compared to wheat ($115) and barley ($112)[1]. Despite slightly higher input costs for canola, net returns from canola averaged $17-20 per acre higher during the 1980's. This difference in profitability generates approximately $120-140 million annually in additional Prairie farm income.

Canola is more advanced than most crops in terms of value added activity. The direct economic benefits of the canola crushing sector are listed below, based on 1989 data.[2]

Value of seed purchases
(1.362 million t) ..... $370 million

Value added benefit of crushing
(1.4 million t) ..... $60 million

Value added benefit of refining
(0.4 million t) ..... $90 million

Estimated value added multiplier effect
($150 mil x 1.5) ..... $225 million

Total Direct economic benefits ..... $745 million

In addition to direct economic benefits, the canola crushing sector makes a positive contribution to the Canadian balance of payments as follows (1989 data):

Import replacement (domestic sales
of canola oil & meal) ..... $264 million

Export earnings
(canola oil & meal) ..... $204 million

Total Contribution to balance
of payment ..... $468 million

2. Integration and Consolidation in the Global Oilseed Crushing Industry

Canadian industries, including agriculture, face growing concentrations of economic power in the U.S. and world markets. Multi-national corporations with strong bases in the large western market economies have been leaders in this trend towards global integration, while relaxed regulatory and

[1] Source: National Grains Bureau
[2] Source: Canola Crushers of Western Canada

anti-combines legislation have permitted, if not promoted, the process.

The U.S. soybean crushing sector, the major supplier of vegetable oil and protein meal to the North American market, exemplifies this global trend toward integration and concentration. Between 1980 and 1989, the share of capacity controlled by the six (five in 1989) major companies rose from 70 percent to over 85 percent. Average daily crush capacity for the plants owned by these firms rose from 1400 to 1800 tonnes/day over the same period.

The large U.S. soybean crushers are characterized by their integration into related market activities such as grain purchasing, merchandising, and exporting; railway, river and ocean transportation; and oil refining, feed manufacture, and industrial product preparation. These activities, as well as international linkages established by all of the major U.S. soybean crushers, have the potential to contribute significantly to their economies of scale and overall profitability.

Many of the same problems that characterize the Canadian canola crushing sector, namely, low capacity utilization and poor crushing margins, existed in the U.S. soybean crushing sector a decade ago. This provided the impetus for rationalization of ownership in the past decade, and has yielded a mature industry.

Increasing concentration and integration is not limited to competing industries as described above, but also characterizes customers of canola products in such areas as food manufacturing and food retailing. Amid these changes, the Western canola crushing industry remains a collection of relatively small firms, largely unchanged from the industry structure of ten years ago. The Western canola crushing industry, even on an aggregate basis, is in a relatively weak position vis-a-vis many of its competitors and customers.

B. Major Issues

1. Domestic Issues

(a) Oilseed Crushing Sector

(i) Ownership and Management

Many of the factors affecting the viability of the crushing sector are beyond Canada's direct control. It is important that domestic policies offset rather than compound the effect of adverse international factors. This is not the case in the canola crushing sector, which currently bears the cost of various policies counter productive to canola processing. Government support for crushing plants, either direct or indirect, has proven detrimental to the development of the canola crushing sector. Alberta Terminals Canola Crushers Ltd. (ATCCL) is an example of how government involvement is able to distort markets and retard industry development.

Diffusion of ownership and the related independence or isolation of decision making in the operation of crush capacity has contributed to a poor economic environment for the industry in general. At the same time, this industry structure with its multitude of owners and independent management has served as a barrier to enhanced industry operating efficiencies that might be obtained through ownership rationalization.

(ii) Capacity Utilization

Although the oldest crushing plant in Western Canada dates back to the 1940's, most of the Western crushing capacity was built between 1975 and 1981 during a mood of optimism and expectancy. This era of expansion was a reaction to the development of canola quality varieties in the early 1970's and the forecast of growing canola acreage and export markets for canola products.

During the 1980's, canola crushing capacity was added to two soybean plants in eastern Canada. This was partly a response to the developing Ontario canola production base, but also a defensive strategy to supply the expanding Eastern Canadian canola oil market.

Annual canola crushing capacity in Canada currently totals approximately 2.2 million tonnes, of which 1.6 million tonnes is located in Western Canada. Two thirds of the 600,000 tonnes Eastern capacity can be used for either canola or soybeans[3].

Comparing the industry capacity figures with the 800-900,000 tonnes of canola crushing capacity necessary to supply the Canadian canola oil market illustrates the expectation that export markets would be developed and maintained, thereby utilizing crushing capacity. However, exports of canola products have

[3] Current Canadian oilseed crushing and oil refining facilities are listed in Appendix 2.

not developed as forecast. Canadian canola crushings peaked in 1987/88 at 1.6 million tonnes, but since that time, have declined to 1.2 million tonnes per year, or roughly two thirds of dedicated canola capacity.

In retrospect, decisions by industry, some financially assisted by government, to expand capacity to current levels appear imprudent in that they were based on incorrect assumptions regarding export market access. Despite world vegetable oil and protein meal market expansion in the past 10-15 years, highly subsidized competition and subsequent erosion of Canadian access to export markets have largely mitigated the benefits of growing international trade.

Intermittent plant shutdowns and reduced plant operating rates as a result of inaccessibility to markets have contributed to poor financial returns, but until late 1990 did not result in any permanent plant closures. In November, 1990, the owners of the United Oilseed Products Inc. plant at Lloydminister, AB. indicated their intention to close the plant permanently. The plant had not operated for more than a year.

With relatively stable domestic canola oil consumption, the rate of capacity utilization largely reflects the situation of declining canola oil export markets. Since the 1970's, canola oil and meal have been 'crowded out' of various export markets as a result of expanding oil and meal production in various countries, and in many cases by the use of subsidies to effect their disposal.[4]

In the late 1980's, it appeared that the loss of offshore export markets could be replaced by canola oil exports to the U.S. as a result of GRAS status (1985). This has occurred to some extent in that the U.S. is currently the largest importer of Canadian canola oil. However, even in the U.S. market Canadian oil is being undercut by subsidized European low erucic acid rapeseed (LEAR) oil.

Current export volumes point to the need for rationalization of the crushing sector to match current North American markets.

[4] The development of canola oil and meal markets is outlined in Appendix 3.

(iii) Operating Efficiency and Financial Condition

The excess capacity in the Canadian canola crushing sector results in very inefficient levels of operation for most plants, and thus for the industry in aggregate. For example, a recent study suggests that the difference in Western Canadian canola crushing costs, between 50% and 90% capacity utilization, is $26-27 per tonne of seed processed[5]. Low capacity utilization reduces competitiveness in export markets and has led to predatory pricing among Canadian canola crushers.

Canola crushers recognize the significant U.S. market potential for canola oil, and the need to develop it and secure it for the future. However, inadequate crushing margins for a prolonged period has them struggling for survival in the short-term.

(b) Government Related

(i) Transportation policy

With production in excess of domestic demand, the canola industry is dependent on an efficient transportation system to move seed, oil and meal to export positions. As is the case with most agricultural commodities, transportation costs represent a significant proportion of canola's value and thus play an important role in setting canola prices in Western Canada.

Discussion of grain transportation policy in recent years has centred on the method of allocating the roughly $700 million annual Western Grain Transportation Act (WGTA) subsidy. Analysis of this issue has been extensive in recent years, but conclusions vary considerably. Crushers consider the method of payment issue a major factor in their competitive position, and have long advocated a change from the current system.

There is a wide consensus that the current method of paying the subsidy to the railways results in higher on farm prices than would be the case if the subsidy was paid directly to farmers. In the latter case, shippers (including farmers) would pay full compensatory rail rates and local seed prices to crushers and others would be lower. Although the potential reduction in prices is not known, it is clear that the

[5] Landell Mills Commodities Studies "The Impact of the Reduction or Elimination of the Japan Customs Oil Tariff on the Western Canadian Canola Industry", (1990).

current method of payment results in higher seed acquisition costs for Western crushers and is a deterrent to value added processing of canola on the Prairies despite several offsetting provisions. These include the listing of canola products as commodities eligible for WGTA rates to Thunder Bay, and the use of Minimum Compensatory Rates (MCRs) for canola product movements east of Thunder Bay by rail to domestic markets.

The benefit to crushers of these provisions does not counter the cost of higher seed prices, however. WGTA rates on product movements to the U.S. apply only to movements via Thunder Bay, which represent a small percentage of the total. All other product movements to the U.S. are shipped at full compensatory rates. MCRs cover only variable operating costs and are thus considerably lower than full compensatory rates, but apply to only half of the total distance in many cases.

These provisions could be removed along with a change in the method of payment and still provide Western crushers with a net benefit. The Canola Crushers of Western Canada estimate the potential benefit to be $18 million per annum, of which, perhaps one third would be retained by crushers. The remaining benefit would be transferred to both farmers and oil and meal buyers in the form of higher seed prices and lower product prices. Longer term, a rationalized ownership structure and decreased predatory pricing of products in the Western crushing sector would allow retention of a larger portion of the estimated $18 million benefit.

(ii) Regulatory environment

With a small population and domestic consumption relative to crop production, the Western Canadian grain industry has long been geared toward meeting the requirements of major overseas processors for consistent quality commodities in bulk shipments. Regulations governing the purchase, handling and transportation of grain were developed in the early part of this century around this central consideration. Despite a number of reviews and modification of regulations, this basic orientation still prevails.

Today, the regulatory system, and to some extent the associated transportation and handling infrastructure, is guided by third party influence. Regulations that ensure commercial integrity and product quality are clearly desirable. However, regulations that affect supplies and prices negatively via delivery patterns and other provisions do not allow markets to work as intended. In this context, current regulations are, in some cases, not compatible with industry initiatives to enhance market performance.

(c) Competitive Position

Canada's agricultural production potential and sparse population contribute to its status as a large exporter of agricultural products. The following table compares production costs for canola and canola oil (rapeseed where applicable), and canola processing costs.

Table 1

Canola/Rapeseed, Oil and Crushing Costs in Selected Countries

Country	Seed Prod'n Cost	Canola/ Rapeseed Oil Cost[1] (US$/tonne)	Canola/ Rapeseed Crushing Cost
Canada	228.5	491.4	41.8
France	238.1	516.2	39.6
West Germany	245.2	534.4	38.3
Poland	267.2	590.8	39.3
UK	225.2	483.1	42.3
Italy	n/a	n/a	45.6
Japan	n/a	n/a	48.1
South Korea	n/a	n/a	34.6
Average[2]	231.9	383.1	41.2

[1] Based on a soymeal price of US $275/tonne

[2] Seed and oil costs are weighted averages based on 1984 data

Source: Landell Mills Commodities Studies, "Oils and Oilseeds Costs of Production", March, 1987.

The data suggest that Canada has a comparative advantage in canola and canola oil production over the competitors listed, with the exception of the U.K. In terms of crushing costs Canada is slightly above average, a reflection of the problems already cited in this report.

This information suggests a sound position for the Canadian industry, but in practice comparative advantage is often rendered irrelevant in today's world of agricultural subsidies and other distortive economic influences. It is important to note that competing regions are making rapid improvements. In addition, canola and its products compete with soybeans and soybean products, which frequently have a competitive advantage relative to canola. It is important that research, and efforts to apply new findings at the production and processing levels be continued in order to enhance the competitive position of canola, particularly in the North American marketplace.

(d) Marketing Systems

(i) Current Open Market System

The Winnipeg Commodity Exchange (WCE) is the focal point of the current open market system of marketing canola in Canada. The cornerstone of the WCE is the futures market, a formalized forward market with prescribed contract terms of grade, place and time. In addition to the futures market, the Exchange conducts a daily 'cash call' market on which producer loaded railcar lots of canola are traded in compliance with the Canadian Grain Commission ship to sales policy.

The major characteristics of the open market system for canola are listed below:

1. An open, visible price discovery mechanism at the WCE.

2. Greater flexibility, relative to board-grains, in the timing of deliveries and thus the ability to manage cash-flow.

3. The option of selling upon delivery or pricing at any time during a 90 day period following delivery, in either case receiving the full market price at the time of selling.

4. The option of pricing physical commodity but benefiting from future price changes by taking positions in the futures market.

5. The option of contracting production, with or without a fixed price, prior to seeding or at any time hence up to the time of delivery.

As well, some objections to the open market system are cited.

1. Inability to maximize overall producer returns.

2. The effect of price volatility on farm gate prices.

3. Farmers' desire to specialize in production, and market commodities through a central desk selling agency operating on their behalf.

4. Vulnerability of prices to negative influence by large, integrated companies.

As a result of the marketing options and access to a dynamic price mechanism inherent in the open market system, farmers have greater control over selling, prices, and the timing of cash-flow. Farm gate canola prices reflect farmers' ability to collect and evaluate market information and make prudent marketing decisions.

In 1989, The Winnipeg Commodity Exchange established a Canola Futures Contract Task Force to review the existing contract in the light of changing parameters and demands in recent years. These include the Canola Cash Call Market, the ninety day pricing limit on storage receipts, changes in producer-car policy, past volatility in the 'basis' (defined here as the difference between nearby futures and Prairie street prices) caused in part by substantial quantities of unpriced grain in the commercial system, and requests by crushers for a change in the contract basis point, Vancouver, to an inland basis point.

Hearings were conducted in the fall of 1989 by the Exchange Task Force. This process generated the following objectives and tests which a new canola contract structure should meet.[6]

[6] These objectives are developed further in Appendix 4.

1. The market structure must provide that cash and futures converge during the delivery month.

2. There must be delivery on the futures and arbitrage between cash and futures. There should be easy access by all participants in the market.

3. The 'basis' must be rational. Premiums and discounts from the futures price at any location or time should reflect demand, supply, carrying costs, freight, handling costs, and associated risk.

4. The price discovery mechanism must be responsive and responsible

5. Integrity of both the marketplace and the price discovery mechanism.

6. The interests of all market participants must be considered.

7. The logistical efficiency of the handling and transportation system must be maintained at an optimal level.

The primary functions of a futures market are price discovery and risk transfer. The threat of delivery against futures contracts causes cash and futures prices to trend towards convergence and thereby assists the integrity of the price discovery process. Perfect convergence rarely occurs because of spacial, temporal and other types of disparity between cash and futures positions, even within delivery months. Although significant quantities are delivered against WCE futures, the acquisition of physical commodities is not a primary role of futures markets.

The current canola futures contract is deemed fully adequate by Japanese importers (crushers) and Canadian exporters, but is viewed as unsatisfactory by domestic crushers. This dissatisfaction with the futures price relative to product prices, although directed to the Exchange in recent years, is a consequence of the inherent squeeze between Japanese buying power for canola and an abundant supply of oilseed products in North America. The Japanese vegetable oil import tariff increases the purchasing power of Japanese crushers by up to $60 per tonne of seed and although a benefit to canola growers, *is a major factor in the competitive position of domestic crushers*. In terms of nominal futures prices, the current contract reflects the reality of the current market, which is dominated by Japanese importers with buying power far in excess of Western crushers'. In terms of its two primary roles, price discovery and risk management, the contract is functioning properly but nevertheless is perceived by crushers as having a bias against them.

(ii) Alternative Marketing Systems

The operation of parallel marketing systems for Canadian grains and oilseeds inherently generates debate regarding the inclusion of various commodities in central desk and open market systems. The debate is often characterized by firmly entrenched positions.

The major characteristics of the CWB system relative to opportunities for the canola industry are listed below.

1. The ability to effectively negotiate, directly or indirectly, with major buyers, private or government, for large quantities of a commodity or product tailored to meet differing specifications while still making possible the benefits from a coordinated bulk movement.

2. The potential to sell at differentiated prices based on specific buyer requirements and other competitive factors, while pooling the results among producers.

3. The ability to assess long-term market potential and to give long-term supply assurances to key buyers.

4. A possible reduction in hedging costs for grain companies and crushers.

5. The ability to contract acreage or run a selected pool account if necessary to meet the specific requirements of premium buyers.

6. Demonstrated integrity and effectiveness in dealing with producers, industry, customers and government.

As well, some objections to the placement of canola under the jurisdiction of the Canadian Wheat Board are cited.

1. Possible alienation of our largest export customers, the Japanese, who have clearly stated that they are not in favour of

central desk selling of canola, and that if imposed, they will seek alternative sources of supply.

2. Objection by some producers to pooling of canola returns because of loss of pricing flexibility and the ability to cash in on short-term open market price movements, especially in view of canola's position as the major cropping option in Western Canada capable of generating an above average economic return.

3. The loss of canola as an open market commodity could lead to closure of the WCE, perhaps moving the establishment of prices for other commodities into U.S.

4. A shift to central desk selling would not alleviate the effects of current problems in the crushing sector.

5. Possible cross subsidization from producers to crushers if canola prices are differentiated according to ability or willingness to pay.

Perhaps the major reason for supporting either central desk selling or the open market system is rooted in individual confidence in the merits, past performance, and future potential of the respective systems. Both systems are able to provide supply assurances, promote effective negotiation, and allow for contracting of production and pooling of prices[7].

Modifications to the marketing system for canola must take into account the size, consistency and overall importance of the Japanese market for canola, and the impact of the Japanese market on farmer returns for canola. Japanese buyers have clearly stated that they prefer the current methods of purchasing and pricing canola seed and canola products.

Changes to the marketing system should take into account the needs of both customers and the Canadian canola industry.

[7] Pooling of prices is limited to voluntary participation under the current open-market system.

2. *International Issues*

(a) International Trade Distortions

Canola oil and meal markets have shifted dramatically in the past 10-15 years. The reasons for this shifting include a decline in Canadian food aid shipments and increasing competition from competing products. Most problematic for the Canadian canola industry in this area, however, is the effect of international trade distortions on export market access. Various markets have been developed by the Canadian industry only to be taken over by a lower cost, generally subsidized product. The trade distortions that affect the domestic canola industry most are listed below[8]. They are not necessarily listed in order of priority.

(i) EEC Common Agricultural Policy

Includes provision of huge subsidies for the domestic production and processing of agricultural products.

Has resulted in a rapid expansion of rapeseed production and exports of LEAR oil.

EEC LEAR oil has under-cut Canadian oil in the U.S. and other markets, and is a major factor in the reduction in Canadian canola oil exports.

(ii) Japanese Customs Tariff On Imported Canola Oil[9]

The Japanese customs tariff on imported canola oil is a fixed rate tariff, currently equivalent to $153 per tonne or 28 percent of canola oil value.

Is an effective barrier against imported oil and increases Japanese crushers buying power by up to $60 per tonne of seed.

Resulting higher Canadian seed prices benefit canola producers but reduces domestic canola crushers competitiveness, particularly in export markets.

(iii) U.S. Export Subsidies

Major program is the Export Enhancement Program (EEP), launched in May, 1985.

[8] A review of changes in canola oil and meal markets, and a summary of the major trade distorting influences are included as Appendices 3 and 5.

[9] For an in-depth study see Landell Mills Commodities Studies, "The Impact of the Reduction or Elimination of the Japan Customs Oil Tariff on the Western Canadian Industry", (1990).

EEP has included vegetable oil sales of 531,000 tonnes (or nine percent of total vegetable oil exports) at an average subsidy of US$126.00 per tonne between 1985 and 1990.

The share of Government-assisted exports of vegetable oil (all programs combined) rose from 25 percent in 1979 to 76 percent in 1989.

(iv) U.S. tariffs on canola and canola products

Currently being phased out over ten years under the CUSTA, but may be eliminated earlier under provisions for accelerated tariff reduction.

Tariff rate on oil roughly double that of seed favours the export of raw canola as opposed to the export of oil and meal.

Reduces competitiveness of Canadian canola crushers in the U.S. vegetable oil market.

C. Implications

1. Deterioration and Potential Loss of the Industry

In recent years, increasing attention from various sources has been focused on the problems and issues facing the crushing sector, but most issues remain unresolved. This lack of change is partly because other sectors of the Canadian canola industry are enjoying reasonable stability and profitability. However, if left unchecked, the issues and problems cited by the Task Force could lead to the eventual demise of the crushing sector.

Competition in the export of raw seed is likely to increase in the next decade from the EEC and possibly other areas. Japanese importers will have alternative seed supplies to choose from, and it is thus important that their confidence in the Canadian canola industry be maintained. A vibrant domestic crushing sector is important in maintaining Canadian canola acreage at current levels, which in turn fosters confidence in the Canadian canola industry by importers of canola and canola products.

It is important that economic conditions in the crushing sector be stabilized and enhanced so as to mitigate further deterioration. The related benefits may accrue primarily to the crushing sector, but will extend to the entire industry.

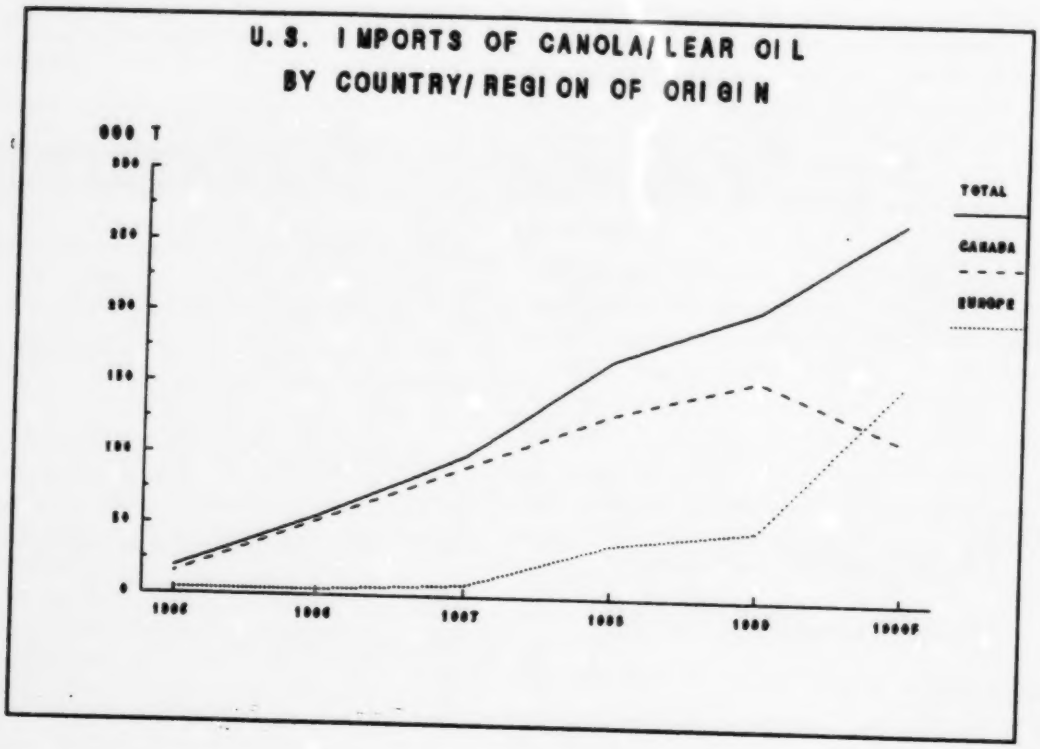
2. U.S. Market Opportunity

The importance of the U.S. market for canola products has grown as a result of Canada's declining share of offshore product markets in the past decade. Furthermore, canola oil has reached a 60 percent share in the Canadian vegetable oil market, with further increases in domestic consumption likely to be linked to population growth.

The Canola Council of Canada in its *Blueprint for the '90's*, said the U.S. market was "... the single greatest and sustainable opportunity the canola industry has ever had since its inception." They went on to say, "Properly addressed it could serve as the new foundation so desperately needed to rebuild and expand the Canadian canola industry." If not properly addressed, they warned that in a few years an integrated U.S. canola industry could be a threat and worsen the financial predicament of the entire Canadian canola industry.

The U.S. food market was not open to canola oil prior to the granting of GRAS (Generally Regarded As Safe) status by the U.S. Food and Drug Administration in 1984. Since then canola oil has gained a 2-3 percent market share of the seven million tonne, and growing, U.S. vegetable oil market. This is a small share given strong U.S. consumer concern about health factors (cholesterol, saturated fat, etc.) and the recognized low saturated fat content advantage of canola oil (6%) relative to other vegetable oils such as soybean (15%), corn (13%), sunflower (11%) olive (14%), and palm oil (51%). Poor processing margins in the crushing sector have limited its forward integration into U.S. markets, and the extent to which it has capitalized on the U.S. opportunity.

Another limiting factor is the reality that the benefit of Canadian market development efforts are extending beyond the Canadian industry. The EEC has been a major beneficiary of Canadian market development efforts in recent years, not to mention the work that went into achieving GRAS status in the U.S. for canola oil. The growing share of subsidized EEC rapeseed oil in the U.S. market (Figure 1) emphasizes the ability of economic distortions to skew trade flows and undermine market development work. In the longer term, the indication that EEC LEAR oil exports are set to increase, and the apparent indifference in the U.S. to the highly subsidized EEC oil are cause for additional concern.



SOURCE: U.S. DEPT. OF COMMERCE, NOB PROJECTION

Figure 1

Recommendations

A. Domestic Issues

1. Oilseed Crushing Sector

Recommendation

That the Alberta government divest itself of ownership of ATCCL and work with industry participants and other Governments to help reorganize ownership in the Canadian canola crushing sector.

Recommendation

That governments allow rationalization of ownership in the Canadian canola processing industry to an optimal structure.

Rationale

These recommendations relate to the problems of excess capacity relative to current markets, destructive competition in product markets, and continual operating losses in the crushing sector. The need for this action has existed for many years and has been considered previously, but has not been acted upon partly in the hope that conditions would improve in due course. Mounting financial losses in the crushing sector in the 1980's are a testimony to the error of this view, the need for dialogue among owners, and a united effort to determine the optimal size and structure of this industry sector.

2. Government Issues

(a) Value Added Processing

Recommendation

That industry participants and Governments develop a commitment to domestic value added processing. One of the primary issues in need of resolution is the impact on domestic crushers of the method of payment of the Western Grain Transportation Act (WGTA) subsidy. The Task Force seeks a resolution of the present disadvantage for Canadian canola processors of the current WGTA legislation, within the context of total industry requirements, specifically resulting in improved benefits and cost savings for farmers and processors.

Rationale

The federal government has had a significant role in the success of the canola industry to date. Examples of major funding initiatives include ongoing grants to the Canola Council of Canada for its Canola Utilization Assistance Program, and the multi-million dollar expense incurred in attaining GRAS status for canola oil in the U.S. Despite past involvement, the current mood in the canola industry includes frustration due to a perceived lack of commitment to continued success, particularly in the area of value added processing.

The time frame for changes in this environment is important. Uncertainty regarding issues such as the method of payment is, in some cases, preventing investment in and/or rationalization of the crushing

sector. A coordinated, well reasoned strategy is required in order to enhance the Canadian oilseed industry's growth, competitiveness, and long term economic viability.

(b) **Regulatory Environment**

The Task Force, with the exception of Prairie Pools Inc. and J. Leibfried, recommends:

- that delivery quotas and permit book entries for canola, and the requirement to report canola inventory positions to the Canadian Wheat Board be eliminated;
- that bonding rates reflect financial viability and risk in all sectors of the industry; and
- overall regulatory review and modification of regulations to increase cost efficiency and the ability of market forces to effect the flow of commodities into and through the commercial handling system.

Prairie Pools Inc. and J. Leibfried believe that regulatory change should be done only as part of a total industry consultation process including all other grains and oilseeds.

Rationale

The recommendations are intended to allow market forces of supply, demand, and price to regulate the flow of canola into and through the commercial system.

Current regulations may limit innovative programs which could, for example, further reduce the need for on-track grain storage.

(c) **Export Finance Instruments for Processed Canola Oil and Meal**

Recommendation

That if the GATT negotiations fail, the Canadian Government respond to the Canadian oilseed industry in its bid to become competitive in export markets by extending the same form of credit sales facilities as those used by their major competitors. This could include such measures as extended terms of repayment, concessional rates of interest, and subsidized product prices.

Rationale

The reality of the international export market for vegetable oil and oilseeds is a proliferation of concessional finance instruments of various forms by competing suppliers. The Canadian Government has resisted endeavours by Canadian canola crushers to seek access to similar forms of concessional export financing relating to credit and price. Simple export credit on commercial terms is not adequate or realistic as a competitive instrument in the world market for export vegetable oil and oilseeds especially in view of the EEC crush subsidy and the U.S. export programs.

Unless and until international trade rule resolution is achieved and agricultural commodity trade discipline accomplished under the GATT, the Canadian industry requires export finance instruments which are competitive in design with those of other export suppliers.

Because of the highly volatile nature of the competition, program specifics will likely vary from time to time. U.S. export programs continue to be the dominant factors in the area of export finance.

(d) **Trade Aid Policy**

Recommendation

That if the GATT negotiations fail, the CIDA bilateral food aid program be redesigned to accommodate both commercial and humanitarian interests. In cases where commercial imports and Canadian aid donations are combined to meet domestic requirements, the memorandum of understanding which establishes the bilateral food aid program should include a commitment by the recipient to make minimum annual commercial purchases of Canadian canola oil

Rationale

The canola crushers have been in the past significant participants in the food aid program aspects of Canada's Official Development Assistance commitment. In some cases the industry developed commercial opportunities from the lead taken by CIDA in fostering economic recovery in recipient nations. The reality of the marketplace, however, is that food aid recipients have little or no allegiance to Canadian vegetable oil suppliers for their commercial requirements when the competition offers a similar product under concessional finance terms. In those instances the opportunity to expand exports is lost because there is no provision to secure a commercial contract as a condition to continuing food aid assistance.

(e) Other

Recommendation

The Task Force recommends that farm income stabilization programs be designed to be crop neutral with regard to both production and trade.

3. *Competitive Position*

Recommendations

(a) Funding of Current Industry Initiatives

That the Canola Council of Canada's modified *Blueprint for the '90's* be adopted by industry and government; and that funding necessary to implement associated research, technology transfer, and market development programs be granted by Western Economic Diversification Canada to meet the challenges of the extremely competitive international oilseed market.

(b) Longer Term Research and Development Efforts

That grower, industry and government funding for canola research and development programs be increased so as to enhance the competitive position that Canada has developed in production and quality; and that such funds be channelled through established organizations such as the Canola Council of Canada.

Rationale

The Canadian canola industry is being challenged in both the areas of quality and cost competitiveness. Improvements in both of these areas are critical in order to have a viable base for both exports and value added processing. The low rate of research and development expenditure in the Canadian oilseed industry relative to competitors emphasizes the need for accelerated technology development and implementation. Related investment of capital is prudent because resulting increases in competitive position are not countervailable.

After six years of GRAS status in the U.S., it is clear that the U.S. market shares for canola oil targeted in the "Blueprint" will not be easily achieved. Adoption of the *Blueprint for the '90's* by the entire canola industry would further acknowledge market potential, provide the impetus to coordinate efforts, and increase Canadian canola oil's presence in targeted markets.

4. *Canola Marketing*

(a) Marketing Systems

The Task Force, with the exception of Prairie Pools Inc. and J. Leibfried, recommends that the current open market system for canola be retained. Prairie Pools Inc. and J. Leibfried advocate the placement of canola under the jurisdiction of the Canadian Wheat Board.

(b) Development of Canola Options

Recommendation

That the Winnipeg Commodity Exchange be granted funding by Western Economic Diversification Canada for the establishment of canola options, including a significant educational effort within the farm community regarding the use of options, price relationships, and marketing opportunities.

Rationale

While futures contracts are particularly suited to commercial merchants, enabling them to offset the risks of price change by hedging their positions, options are more appropriate for the needs of producers and processors. Under the current open marketing approach to canola, options have the potential to enhance the pricing options available to farmers, particularly in establishing minimum prices in advance of harvest or actual delivery. This will likely be facilitated in part by grain company involvement in the options market, and subsequent offerings of minimum prices to farmers. Direct farmer involvement in the options market is not precluded, but widespread direct farmer use will be dependent on a successful promotion and education program.

Efforts to provide farmers with marketing information should not be limited to the Winnipeg Commodity Exchange or facts relating to options markets. An educational campaign to increase producer understanding of various price linkages and marketing opportunities should be a priority for governments in conjunction with interested organizations.

(c) Crusher Representation on the Winnipeg Commodity Exchange Board of Governors

Recommendation

That to further dialogue and understanding between the canola crushing sector and the exchange, a representative from the Western Canadian canola crushing sector be elected to the Board of Governors of the Winnipeg Commodity Exchange.

B. International Issues

1. Accelerated tariff reduction

The Canada-U.S. Trade Agreement provides for accelerated tariff reduction on oilseeds and products, if mutually agreeable to both countries. With a goal of ensuring the continued success of the Canadian canola industry, the Task Force recommends accelerated tariff elimination for canola and canola products. As well, the Task Force recommends that a clause clarifying rules of origin for Canada-U.S. trade of oilseeds and products be included, stating that tariff-free status apply only to products of North American origin.

2. Japanese Vegetable Oil Import Tariff

The Task Force recommends that the federal government negotiate the removal of the Japanese vegetable oil import tariff, but only in conjunction with an overall reduction in production and export subsidies in competing oilseed producing regions. The Task Force recognizes that the Japanese oil tariff is a major detrimental factor negatively affecting the competitive position of domestic processors.

3. Importance of a Trade Environment free of Distortions

Recommendation

That the Federal Government continue maximum effort to establish an international trade environment free of distortions so as to facilitate increased exports of canola and canola products. In the immediate future, this effort should focus on the problem of subsidized European LEAR oil entering the U.S. in direct and unfair competition with Canadian canola oil.

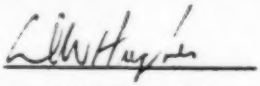
Rationale

A fair international trade environment is a necessary condition for a viable, export oriented industry. The positive impact of market development efforts can be quickly mitigated by distortive factors, as currently exemplified in the U.S. canola oil market. Subsidized EEC LEAR oil is entering the U.S. at up to US$60/tonne below Canadian canola oil. As a result, Canadian crushers have had to reduce their prices in order to maintain some portion of the U.S. market. The EEC is clearly benefitting from Canadian market development efforts and expenditures, and will likely be in a position to continue this pattern unless sufficient pressure and possibly countervail action by the U.S. are administered.

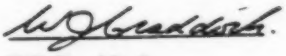
The rules, or lack thereof, governing international trade can also offset the benefit of improvements to the domestic industry. At present, the Canadian canola crush for export is just 300-400,000 tonnes, or 25-30% of total crush. Improvements to the domestic policy environment and in the crushing sector have the potential to make crushing for the domestic market profitable, but compensating for international distortions is much more complex. Establishment of the proverbial 'level playing field' via both bilateral and multinational negotiations, is crucial to maintaining and increasing the export orientation of this industry.

Appendices

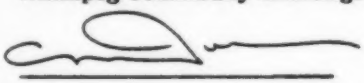
Appendix 1: Task Force Members



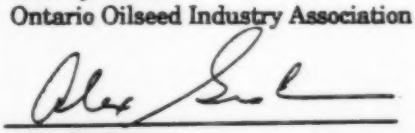
David Hughes, Chair
D.W. Hughes Management Ltd.



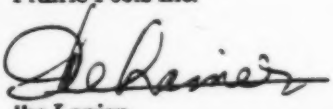
Bill Craddock
Winnipeg Commodity Exchange



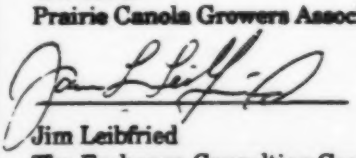
Murray Davis
Ontario Oilseed Industry Association



Alex Graham
Prairie Pools Inc.

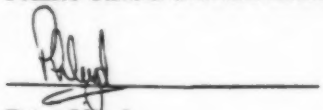


Ike Lanier
Prairie Canola Growers Association

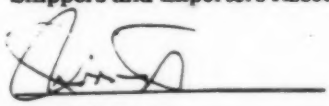


Jim Leibfried
The Exchange Consulting Group

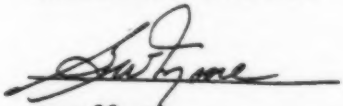
Keith Lewis
Prairie Canola Growers Association



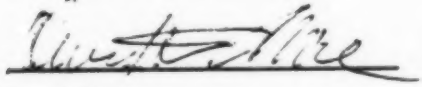
Peter Lloyd
Shippers and Exporters Association



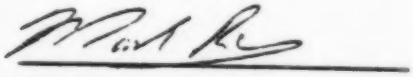
Jim Middagh
Grain Dealers' Association



Gerry Moore
Country Elevator Association



Dwight More
Canola Council of Canada



Mark Roe
Canola Crushers of Western Canada

Appendix 2: Canadian Oilseed Crushing and Vegetable Oil Refining Capacities

Estimated Canadian Canola Crushing Capacity

Company	Estimated Capacity[1] tonnes/day
Alberta Food Products	
Fort Saskatchewan, Alberta	700
Alberta Terminals Canola Crushers Ltd.	
Sexsmith, Alberta	700
Canbra Food Ltd.	
Lethbridge, Alberta	700
CSP Foods Ltd.	
Altona, Manitoba	675
Harrowby, Manitoba	600
Nipawin, Saskatchewan	525
Red Deer Grain Inc.	
Red Deer, Alberta	100
United Oilseed Products Inc.	
Lloydminster, Alberta	702[2]
Central Soya of Canada Ltd.	
Hamilton, Ontario	600
ADM Agri-Industries Ltd.	
Windsor, Ontario	1,200
TOTAL	6,520

[1] Estimated daily capacities refer to the amount of canola which could be processed per 24 hour day if the plants operated at 100% capacity. All of the plants are the expeller-solvent type, except for Red Deer Grain Inc. which is the expeller pressing type.

[2] Closed as of November 1990.

Estimated Canadian Deodorizing Capacity

Company	Estimated Capacity 000's tonnes/year
ADM Agri-Industries Ltd.	
Windsor, Ontario	147
Canada Packers Inc.	
Montreal, Quebec	102
Toronto, Ontario	147
Wainwright, Alberta	73
Total	322
Canada Starch Co. Inc.	
Cardinal, Ontario	27
Canbra Foods Ltd.	
Lethbridge, Alberta	82
CSP Foods Ltd.	
Dundas, Ontario	21
Altona, Manitoba	61
Nipawin, Saskatchewan	54
Total	136
Monarch Fine Foods Co. Ltd.	
Rexdale, Ontario	102
Proctor & Gamble Inc.	
Hamilton, Ontario	68
TOTAL	884

Note: J.M. Schneider, Gainers, Hubberts and St. Jean also have small edible oil operations that process animal fats only.

Appendix 3: A Summary of Changes in Canadian Canola Meal and Oil Export Markets

Canola meal markets

During the early years of quality canola meal production (low glucosinolates) the Western European market, accounted for up to 90 percent of Canadian canola meal exports. With the expansion of rapeseed production in the EEC, the majority of this market has been lost. Today, Norway is the only consistent Western European market for Canadian meal.

During the 1980's, various Asian countries including Indonesia, Japan, and South Korea replaced the European demand for Canadian meal. At the same time, U.S. imports of canola meal increased rapidly to the current 200-300 thousand tonnes annually, or about half of total exports.

Unlike the growing U.S. market for canola meal, there are signs that Canada is being crowded out of the Asian market by local, inexpensive soymeal. Both China and India have increased protein meal exports to other Asian countries in recent years, a bi-product of the expanded vegetable oil production for domestic consumption. Canadian canola meal exports to Japan, for example, peaked in 1987/88 and accounted for 39 percent of total exports. In the last two crop years, this figure has averaged only 19 percent while absolute volume has declined by more than 50 percent. Canadian meal exports to Taiwan have also declined, from a high of 21,000 tonnes in 1984/85 to near zero at present.

Despite its proximity to canola meal production, the feed market in Canada has not embraced canola meal nor made a significant switch from the industry standard, soybean meal. This is a result of perceptual and technical limitations. Since the reduction of glucosinolate content in meal in the 1970's, quality enhancements have received a reduced priority in plant breeding efforts. Varieties were improved in such areas as yield and disease resistance, with an overriding constraint that oil content be maintained at 40 percent or more. This constraint has, and continues, to limit improvements to canola meal quality. Relative to soymeal, its main competitor in feed rations, canola meal remains a product high in fibre, and lower in energy, protein and lysine. This makes it more difficult to convince farmers and other users of its merits, and increases the price discount necessary before it will be incorporated into feed rations.

As a result, domestic canola meal consumption has remained at a relatively low level, and actually declined as a percent of output. From 1979/80 to 1982/83, domestic canola meal use of 375,000 tonnes per year accounted for 69 percent of production, while from 1986/87 to 1989/90 domestic usage of 366,000 tonnes per year averaged just 45 percent of production.

To some extent, the modest acceptance of canola meal by Canadian users reflects processing improvement and plant breeding priorities over the past 15 years. It is also a reflection of strong competition from soymeal, negative experiences with high glucosinolate content rapeseed meal in the early 1970's, and insufficient market development efforts to replace these memories with current information. Acceptance of canola meal in the domestic market and U.S. market development are becoming increasingly important as offshore markets dwindle.

Canola oil markets

Like canola meal, Canadian canola oil markets have shifted dramatically in the past decade. The reasons for this shifting, detailed below, include strong competition from competing oils, reductions in food aid shipments of canola oil, increasing subsidies by competitors such as the EEC and the U.S., and the opening of the U.S. market. The opportunity in the U.S. began as a result of GRAS status on canola oil, and has been enhanced by health concerns about consumption of animal fats and high saturated fat content of tropical and other vegetable oils.

Palm oil production and exports expanded at an unprecedented pace during the 1980's, and was often priced significantly lower than competing oils. Palm oil is the most traded vegetable oil internationally, and ranks second to soyoil in terms of production. It is being imported by countries with varying levels of wealth, but particularly by less developed countries more discerning of price than saturated fat content and other nutritional specifications.

Canadian food aid shipments of canola oil increased for most of the 1980's, peaking at 121,000 tonnes in 1986/87. Since that time, vegetable oil food aid shipments have returned to more traditional levels, totalling 24,000 tonnes in 1989/90 - or roughly early 1980's levels.

Prior to 1986, Canada and the U.S. initiated a development program with the National Dairy Developmnent Branch (NDDB) in India. The purpose of the program, initially intended to span five years, was to donate oil to NDDB which would then sell it on the open market in India and utilize the counterpart rupee funds to improve and develop the oilseed industry in India. The funds are administered by NDDB under the supervision of the Cooperative Association of Canada. The sum of $85 million was allocated over a five year period to be followed by another five years if all went as planned. India's NDDB, due to internal domestic difficulties, did not expend funds in 1986/87 or sell oil held in storage.

A gift of 26,000 tonnes of canola oil was made to Pakistan in 1986/87 based on a perceived requirement for oil in Pakistan but also based on a decision to assist Canada canola crushers. There was also a plan to introduce an NDDB type of development program in Pakistan. However, lacking the cooperative infrastructure of NDDB, Pakistan did not pursue a development program.

While CIDA food oil shipments are minimal, they cover both bilateral assistance as well as World Food Program (WFP) multilateral donations. The WFP has also encountered budgetary problems, thus reducing their requirements.

Agircultural policies in the EEC and the U.S. have resulted in mounting subsidies for both the production and export of oilseeds and vegetable oil. The resulting availability of subsidized soybean and rapeseed (LEAR) oil on world markets has further reduced the level of Canadian canola oil exports.

In the late 1980's, it appeared that the loss of offshore export markets could be replaced by canola oil exports to the U.S. as a result of GRAS status (1985). This has occurred to some extent in that the U.S. is currently the largest importer of Canadian canola oil. However, even in the U.S. market Canadian oil is being under-cut by subsidized European LEAR oil. Since 1985, Canadian exports rose steadily to a level of 139,000 tonnes in 1988/89. In recent years however, the volume of EEC oil into the U.S. has increased and is approaching that of Canadian canola oil shipments. Canadian exports declined in 1989/90 by 28 percent. Over the past two years, the U.S. reported import prices of EEC oil have been U.S. $60-65 per tonne below Canadian canola oil on average. The U.S., without a large canola industry itself, has not initiated countervail action against the EEC in response to this movement.

Appendix 4: Criteria for a New Canola Futures Contract

In 1989, The Winnipeg Commodity Exchange established a Canola Futures Contract Task Force to review the existing contract in the light of new parameters and demands. The Canola Cash Call Market, the ninety day limit on storage receipts, changes in producer car policy, past volatility in the basis caused in part by substantial quantities of unpriced grain in the commercial system, and requests for a change in the contract by crushers all contributed to a new environment that mandated a complete review.

Hearings were conducted in the fall of 1989 by the Exchange Task Force. This process generated the following objectives and tests which a new canola contract structure should meet.

1. The market structure must provide that cash and futures converge during the delivery month.

The delivery process assures convergence of prices at the time, place and grade of the delivery, when the cash commodity is delivered in fulfilment of futures contract obligations. In the real world, it does not necessarily mean that cash and futures will converge at all eligible delivery points, or at any particular date during the month, or for a specific deliverable grade. The buyer may not know where, when, or what day during the month he will receive the grain. Storage and interest costs on canola for a month exceed $4.50 per tonne. Buyers and sellers for specific locations, dates, and grades, will trade the grain at premiums or discounts above or below the constituent costs of moving grain to a desired location and time, depending on supply, demand, and the perceived risk of changes in costs. Thus, while a theoretical futures contract calls for precise and predicatable convergence of cash and futures during the delivery month, in its practical application, convergence means that, generally speaking, for all locations, times, and grades, a commercially acceptable expectation of convergence of cash and futures can be anticipated, and the risk of aberrations can be compensated in pricing decisions.

2. *There must be delivery on the futures and arbitrage between cash and futures. There should be easy access by all participants in the market.*

The delivery process should ideally be consistent with the normal commercial flow. In the case of the alternate delivery terminals in the canola market, they are only economically accessible by truck from relatively nearby points of origin. The impact of the WGTA precludes access by rail. In the interests of financial integrity, documentation must be secure, performance must be guaranteed, and financial stability of the regular facilities must be assured. These can add considerably to the costs involved in the delivery process. In the old Alberta Barley Futures Contract, the requirement that the barley be delivered in specified terminals added costs of some 10% to the value of the barley. The contract failed because of the unnecessary added cost of delivery, and the contract has been withdrawn.

It has been traditional in the delivery process that the owner could store the grain from one delivery month to the next. This 'cash and carry' capability provided a floor to the discount that a nearby contract would trade under the next futures contract. This feature resulted in grain that would remain in store for months. Times have changed. Today the commercial infrastructure of handling facilities in the Canadian grain trade is dynamic. Grain moves through the system, rather than being stored in it. With few exceptions, grain is not stored in commercial facilities in the classical sense. The accessibility of the delivery process must recognize this changing environment.

The principal function of the delivery process is to assure convergence as described above. The market price should be liquid enough to provide the opportunity to exchange cash grain for futures (Exchange For Physical — EFP's) at premiums or discounts that reflect supply and demand, location, time, quality, and risk. EFP's provide the effective commercial accessibility to futures contracts. In the crop year 1989-90, EFP's exceeded delivery in the canola contracts by a factor of 6:1. While deliveries properly represented 2.7% of the volume of trade, EFP's constituted 17% of this volume. The existing canola contract is accessible and is being commercially arbitraged with the cash commodity.

3. *The 'basis' must be rational.*

Premiums and discounts from the futures price at any location or time should reflect demand, supply, carrying costs, freight, handling costs, and associated risk.

4. *The Price Discovery Mechanism must be Responsive and Responsible.*

A liquid, open, accessible, effective, and efficient futures market, with an appropriate mix of commercial buyers, sellers, traders, and speculators, should properly reflect the fundamental economic value of grain, in a specified place, time, and quality. The prices of futures contracts reflect the forces of supply and demand in the present and those anticipated in the future. Premiums or discounts of the cash prices to the futures (the basis) reflect the components of the marketplace as they relate to a specific place, time, and quality, either for spot or forward positions.

5. *Integrity of both the marketplace and the price discovery mechanism.*

The construction of the framework of a futures contract must ensure that all participants have confidence that each component of the market can perform its function in a timely and effective manner. Grain must be delivered and payment must be made as contractually required. Under the recently revised Canada Grain Act, the security held by the Grain Commission from licensees is not available to guarantee performance to any other than the actual producer of the grain concerned. Therefore, other steps are being taken to ensure that operators of regular delivery facilities are financially sound. The mechanics of making payments through the Clearing House and the maintenance of adequate margins must be perceived to provide financial security to the market. The price discovery mechanism itself, in the form of trading rules and membership qualifications, must be appropriate, in the public interest, and enforced. The provisions of the Grain Futures Act, with its authority to oversee compliance, must be rigorously applied. The market must be perceived to have integrity and be in the public interest.

6. *The interests of all market participants must be considered.*

To the extent possible within the constraints of the existing regulatory framework of the Canadian Wheat Board Act, the Canada Grain Act, and the Western Grain Transportation Act, and the various provincial commodities acts, and the regulations of their respective administrators, futures contracts and the market structure should accommodate the needs of as large a segment of the marketplace as possible.

7. *The logistical efficiency of the handling and transportation system must be maintained at an optimal level.*

The price determination mechanism and the hedging facilities of the market must not unduly restrict the efficiencies of the logistical framework that provides for the efficient movement of grain from farm combine or storage, through the transportation, handling, grading, cleaning, and treating processes to the final consumer, be it a feedlot, a crusher, a miller, or to the ship of an exporter.

The pricing mechanism must not inhibit the dynamics of the physical infrastructure. It should have a minimum impact on unnecessary movements, elevations, processing, or storage.

Appendix 5: A Summary of Major Distorting Influences in the International Trade of Oilseeds and Products.

1. *EEC Common Agricultural Policy*

The European Economic Community (EEC) Common Agricultural Policy provides huge subsidies for the domestic production and processing of agricultural products. In terms of oilseeds, and rapeseed in particular, subsidies have resulted in a rapid expansion of production.

Although the EEC remains a large net importer of protein meal, the expansion in oilseed production has made the EEC a net exporter of certain vegetable oils. Rapseeed oil heads the list of vegetable oils exported outside the Community, followed by soybean oil and sunflower oil.

The major EEC rapeseed subsidy is known as the 'crusher subsidy', because it is most often paid to domestic crushers. It enables crushers to pay to farmers prices which are far in excess of the world prices for seed. This ensures that virtually all oilseed production is processed within the EEC. In practice, a portion of the crusher subsidy is retained by crushers. The example EEC price mechanism for rapeseed (below) suggests that producers receive 77% of the subsidy while crushers net the remaining 23%.

If EEC calculated world prices are set below actual world prices, European crushers benefit further. This increases the crusher subsidy (received by crushers), but does not affect on-farm prices. The example suggests that in June, 1990, the net subsidy to European crushers was $101 per tonne, 12% of which resulted because of underestimated world rapeseed prices. The total benefit to crushers is additive to the producer subsidy, which provided for an on farm rapeseed price of roughly $600 per tonne in 1989/90.

One of the growing markets for EEC low erucic acid rapeseed (LEAR) oil is the United States. Although the U.S. canola oil market was initially developed by Canadian interests, the EEC share of imports has surpassed that of Canada. U.S. Department of Commerce import data indicate that European rapeseed oil is priced considerably lower than Canadian canola oil. It implies an average price difference of U.S. $63 per tonne between oil of Canadian and European origin for the period January, 1988 to June, 1990.

EEC LEAR oil has also under-cut Canadian oil in other markets, and is a major factor in the shifts and net reduction in Canadian canola oil exports during the past decade.

Calculation of Net Price and Subsidies to Crushers

For '00' Rapeseed in June 1990

1)	**Calculation of Crusher Aid**	
	Target price	480.66
	– Calculated world price	209.67
	= Crusher aid	270.99
2)	**Net Producer Subsidy**	
	Intervention price	418.60
	– Calculated world price	209.67
	= Net producer subsidy	208.93
3)	**Net Crusher Subsidy**	
	Target price	480.66
	– Intervention price	418.60
	= Net crusher subsidy	62.06
	Net crusher subsidy in Cdn $	89.00
4)	**Net Price to Crusher**	
	Intervention price	418.60
	– Crusher aid	270.99
	= Net price to crusher	147.61
	Net price in Cdn $	211.00
5)	**Comparison of EEC & World Prices**	
	Oil World price — Cdn rapeseed CIF N.W. Europe (Cdn $)	223.00
	– EEC net price to crusher	211.00
	= Additional subsidy	12.00
6)	**Total Crusher Subsidies (Cdn $)**	
	Net crusher subsidy (from #3)	89.00
	Additional subsidy (from #5)	12.00
	Total crusher subsidies	101.00

2. *U.S. Export Subsidies*

The major U.S. export subsidy program, the Export Enhancement Program (EEP) was launched in May, 1985. The intent of the program is to lower the per unit cost of commodities, and thereby expand the U.S. share of various export markets.

During the first five years of the program, EEP sales of vegetable oil totalled 531,000 tonnes at an average subsidy of U.S. $126.0 per tonne. This volume represents approximately 9 percent of total U.S. vegetable oil exports over this period. Soybean, sunflower and cottonseed oil have been sold under the program to five importing countries. They are, in descending order of sales volume: India, Algeria, Tunisia, Turkey, and Morocco.

Other government programs intended to facilitate and expand U.S. agricultural exports include the Sunflowerseed Oil Assistance Program (SOAP), the Cottonseed Oil Assistance Program (COAP), and the Targeted Export Assistance Program (TEA). Under SOAP and COAP, USDA is required to purchase a set amount of sunflowerseed and cottonseed oils (U.S. $20 min in 1989) to facilitate additional export sales. The subsidies enable U.S. exporters to compete at commercial prices in foreign markets by complementing commercial sales with USDA oil stocks.

The Targeting Export Assistance Program is intended to assist market promotion, currently in the form of certificates for commodities from stocks held by the Commodity Credit Corporation. The TEA budget for oilseeds and products averaged U.S. $9.8 million from 1986-1989.

3. *Japanese Customs Tariff On Imported Canola Oil*

The Japanese customs tariff on imported canola oil is a fixed rate tariff, currently set at 17,000 yen per tonne (crude) and 20,700 yen per tonne (refined). In Canadian currency, these rates were equivalent to $153 and $186 per tonne in November, 1990.

The 1979 Tokyo Round of GATT negotiations resulted in significant changes to the Japanese tariff structure for oilseeds and products. Prior to 1980 the canola oil tariff was assessed ad valorem, at a rate of approximately 12 percent. This was changed to the current fixed rate on January 1, 1980. Tariffs on soybean and sunflower oils are set at the same level as canola oil.

Since 1980 the value of the tariff, measured in Canadian currency, has risen and fallen with the value of the yen relative to the Canadian dollar. From a rate of 11.7% ad valorem in January, 1980, the tariff rose to a high of 36.1% in May, 1987, and was equivalent to 28% in November, 1990.

By creating a tariff barrier against imported oil, the Japanese oil tariff raises domestic vegetable oil prices. This affects the prices at which Japanese crushers can economically buy seed, relative to an environment free of tariffs. Landell Mills Commodities Studies (1990) estimates that the tariff increases Japanese crushers buying power by up to $60 per tonne.

Because of the substantial export of Canadian canola to Japan, the tariff's influence extends to Canadian canola prices. Resulting higher Canadian seed prices benefit canola producers, but reduce domestic canola crushers competitiveness.

The position of the Canola Crushers of Western Canada regarding the Japan oil tariff is that the Government of Canada should undertake to open negotiations with the Government of Japan with the intent of achieving removal of the Japanese customs tariff on imported canola oil.

4. *U.S. tariffs on canola and canola products*

The standard U.S. tariffs on canola and canola products, as well as those on Canadian product in 1990 are listed in Table 2. The tariffs on Canadian product are being phased out over a ten year period which began January 1, 1989. To date, they have been subject to two reductions of ten percent each.

Table 2

1990 Tariff Structures for Oilseeds and Products[1]

	Current U.S. Tariff US$	Current Cdn Tariff Cdn$
Canola	7.05/t	free
Canola meal	2.12/t	free
Canola oil (crude)	6%	8%
Canola oil (refined)	6%	14%

[1] U.S. tariffs on Canadian exports and vice-versa. Tariffs applicable to products of other origins are 25 percent higher.

The basis tariff structure favours the export of raw canola as opposed to the export of oil and meal. Table 3 lists the current U.S. tariff on a tonne of canola exported as seed, and also when exported in the form of oil and meal using an oil price of 25 cents/lb. While the tariff on canola meal is lower than on seed, the 6% ad valorem tariff on canola oil is significantly higher. In the example, the canola oil tariff is equivalent to U.S. $13.22 on the oil component of a tonne of seed. The combined U.S. import tariff on the oil and meal produced from a tonne of seed is roughly double the tariff on the seed. The tariff structure represents a barrier to Canadian exports of canola oil to the U.S.

Table 3

U.S. Tariffs on Canola Seed Versus Products in 1990

	Current U.S. Tariff US$	Current Cdn Tariff Cdn$
Canola	7.05/t	free
Canola meal	2.12/t	free
Canola oil (crude)	6%	8%
Canola oil (refined)	6%	14%